CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO. 64 OF THE MONETARY POLICY COMMITTEE MEETING, JULY 7, 2009

The Monetary Policy Committee (MPC) met today to review and discuss the latest domestic and international developments and their implications for the Nigerian economy. The Committee noted the continued adverse effects of weak global demand and falling crude oil production on Nigeria's external and fiscal performance during the second quarter of the year. The MPC noted the reported prospects of economic recovery in some emerging market economies. However, this development is not likely to offset the continued weak economic performance in advanced economies. In view of the openness of the Nigerian economy, the Committee observed that the growth prospects may weaken in the remainder of 2009, more so that inflationary tendencies appear to be persisting.

Key Economic and Financial Developments

Domestic Output

Provisional data from the National Bureau of Statistics (NBS) indicated that the Gross Domestic Product (GDP) at 1990 constant basic prices grew by 4.85 per cent in the first quarter of 2009. It is estimated to grow by 5.13 per cent in the second quarter of 2009 compared with 5.20 per cent in the corresponding period of 2008. The non-oil sector is estimated to grow by 8.03 per cent in the second quarter of 2009 mainly as a result of the performance of agriculture (2.84 per cent); wholesale and retail trade (2.20 per cent); and services (2.28 per cent).

The NBS forecast showed a lower growth of 5.75 per cent in overall real GDP for 2009, compared with 6.41 per cent in 2008, notwithstanding the projected weak performance of the global economy.

Price Developments

Inflation

The Committee noted the marginal decline in headline year-on-year inflation rate to 13.2 per cent in May from 13.3 per cent in April 2009. The persistence of high food inflation at 15.7 per cent in May compared with 15.3 per cent in April remains a matter of serious concern given its overwhelming weight in the consumer price index (CPI) basket. It is, however, expected that the headline inflation would slow down in the coming months on account of slack demand and the likely improvement in the supplies of agricultural produce.

Monetary Developments

Provisional data indicated that broad money (M2) decelerated sharply by 4.9 per cent in the first five months of 2009 in contrast with the growth of 29.9 per cent during the corresponding period of 2008. On a year-on-year basis, M2 grew by 15.6 per cent, mainly on account of the decline in net foreign assets and slowdown in credit to private sector. The decline in net foreign assets reflected the fall in oil export receipts and deceleration in other inflows, calling for policy initiatives to improve the availability of foreign exchange in the system. The slowdown in credit to private sector is not unconnected with the slack domestic demand as well as financial squeeze, requiring a combination of credit and structural measures to ensure that there are no enduring adverse effects of credit slowdown on growth and employment.

Interest Rates

Key interest rates at the inter-bank market rose in May and June 2009. The weighted average inter-bank call rate on unsecured transactions stood at 12.5 per cent in April, 13.2 per cent in May and 18.6 per cent in June. In the first few days of July, the inter-bank call rate ranged from 21 to 22 per cent. The weighted average open buy back rates in April, May and June were 7.1, 7.2 and 7.7 per cent, respectively. The average spread between the call rates and the rates on secured transactions has been very high at 1090 basis points in June, 600 basis points in May and 540 basis points in April.

The average prime lending rate rose from 19.34 per cent in April to 19.53 per cent in May 2009 while the average maximum lending rate declined from 23.17 per cent in April to 22.86 per cent in May. The weighted average rate on all categories of deposits rose from 5.98 per cent in April to 6.13 per cent in May 2009. Thus, the spread between the two rates is higher than the current inflation rate, which provides a unique opportunity to banks to improve efficiency and reduce lending rates.

Exchange Rates

The MPC noted with satisfaction that recent measures to stabilize the Naira exchange rate have posted some positive outcomes. The Naira exchange rate has stabilized at the rDAS in recent weeks while in the other segments, the rates have appreciated, thereby narrowing the arbitrage opportunities. However, the premium over the rDAS rate has remained significant. The present situation offers an opportunity to further narrow the gap between the two rates by measures aimed at further liberalizing the inter-bank foreign exchange market.

External Reserves

Foreign exchange reserves as at July 03, 2009 amounted to US$43.19 billion (provisional) compared with US$53 billion at end December 2008. The decline in reserves mirrored mainly the relative downward drift in international crude oil prices from the levels reached in mid-2008 and the slowdown of other foreign exchange inflows. However, the decline in reserves is likely to moderate in the next two quarters owing to the expected rise in international crude oil demand arising from recent reports of improvement in the recovery prospects in the US and other developed countries and in the relatively favorable outlook for growth in some important emerging economies.

The Stance of Policy

The Committee noted that the recent economic and financial developments point to the need for policies to be focused on growth, exchange rate and financial market dynamics. Monetary and credit policies have to be therefore properly integrated with exchange rate policies. The stance of monetary policy in the coming months would be assure that liquidity, both domestic and foreign currency, is adequate to meet genuine demand and that real lending rates are moderated. To match these forces for bringing about stability in foreign exchange and domestic money markets, the CBN would undertake suitable foreign exchange and domestic open market operations in a coordinated manner in the coming months. For this purpose, the CBN would announce an advance calendar of its operations for each week so that market expectations are formed in a manner that is conducive to the realization of the objectives of policy. The CBN also proposes to have in place firm consultation procedures with bank executives prior to and after the policy meetings as a condition for bringing about a more open and transparent monetary policy.

Decisions:

In the light of the above, the Monetary Policy Committee decided as follows:

1. The monetary policy framework which has the corridor interest rate system as an important component is hereby restored. Consequently, the Monetary Policy Rate (MPR) would be reduced from 8.00 per cent to 6.00 per cent per annum. The corridor of interest rates would be +/- 200 basis

points, with the rate on the standing lending facility at 8.00 per cent and the rate on the standing deposit facility at 4.00 per cent.

2. In order to ensure that the inter-bank market is rendered efficient and to reduce counterparty credit risk, the CBN would provide a temporary guarantee from July 08 to March 31, 2010. The Bank would also impose a limit on the total volume of gross inter-bank loans extended to an individual institution. A guarantee fee will be charged if the guarantee crystallizes at 5 percentage points above the interest rate at which the loan was contracted.

3. Coinciding with (2) above and in order to foster financial stability, banks are expected to publish their accounts with sufficient disclosure to allow for risk assessment and analysis by creditors and investors by the end of March 2010.

4. In view of the fact that the high lending rates would not be consistent with the objectives of growth, inflation control and financial stability, the CBN would encourage banks to bring down the lending rates in line with the economic realities. It is also important that the yield curve is normal with long term yield rates carrying reasonable premium over the short term market rates.

5. The inter-bank foreign exchange market would be liberalized completely with wDAS replacing the rDAS with a view to improving the supplies of foreign exchange in the economy.

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Abuja
July 7, 2009